

PROGRAM MATERIALS
Program #35187
November 6, 2025

Trust Drafting Intensive: Common Drafting Errors & How to Avoid Them

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Lager Of LAWYERS

Drafting Trusts: Learning From the Mistakes of Others

Presented by:

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What is Good Drafting?

<u>Tax Efficient</u> – A properly drafted document takes into account gift tax, estate tax, generation skipping transfer tax, as well as both federal and state income tax.

<u>Creditor Protected</u> - Careful drafting helps protect assets from the creditors of the grantor, and the creditors of trust beneficiaries.

Flexible - Since trusts tend to last for decades, there should be multiple mechanisms to help the trust adapt to changes in the law, the tax rules, changes in the family benefited by the trust, and the need to replace fiduciaries from time to time.

Succinct - I have seen quality trusts ranging from 30 pages to 80 pages. Where possible brevity is preferred. This is not merely an aesthetic. Short documents are more likely to be thoroughly reviewed, understood, and followed by everyone who will encounter the trust after it is drafted. The longer the trust, the more difficult it is for someone unfamiliar with your document to locate a particular provision.









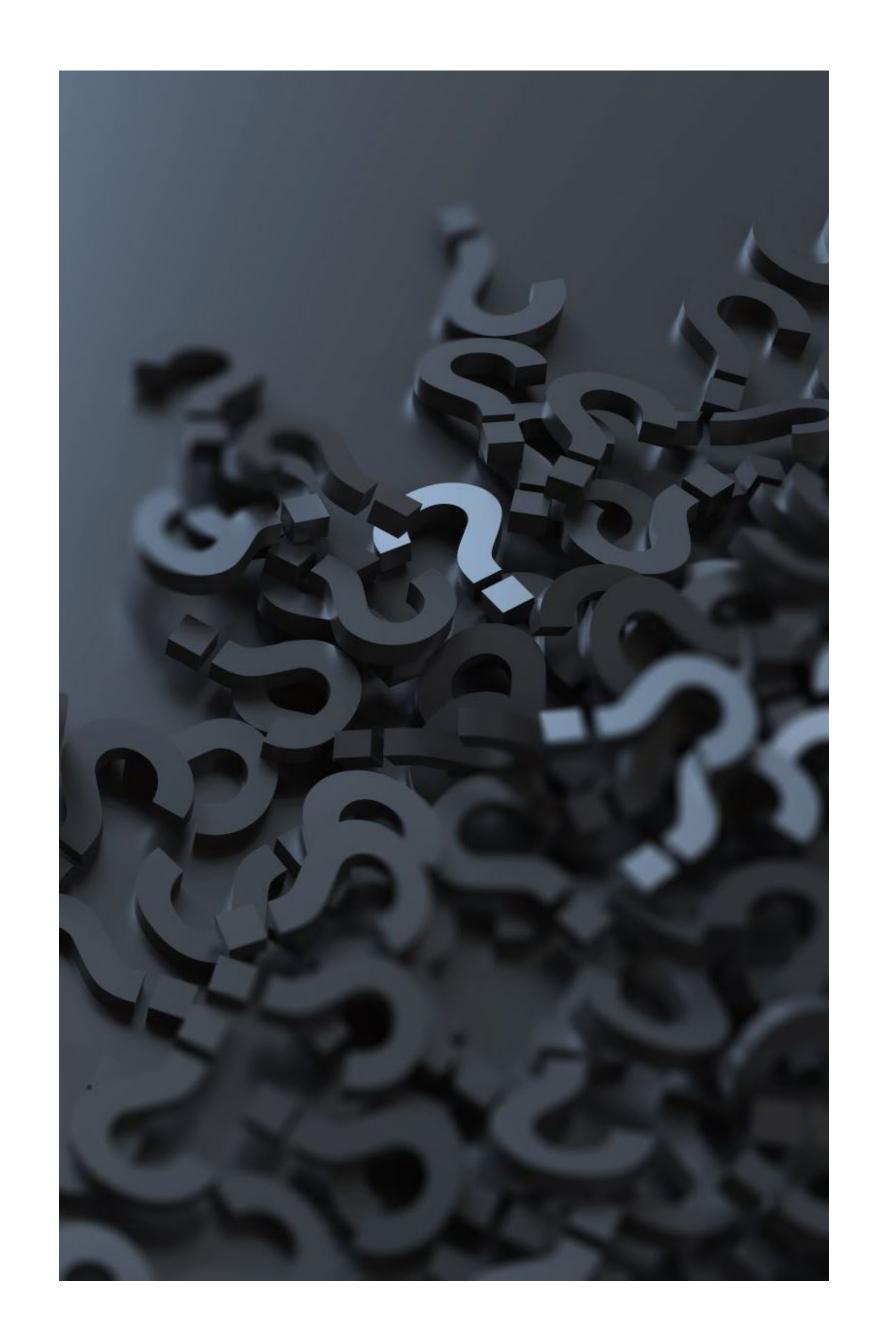
What is Good Drafting?

<u>Unambiguous</u> - This is not contrary to the goal of being succinct. In some instances additional words can eliminate ambiguities, and in those cases we should not hesitate to

include the additional language. In other cases, however, additional language actually creates the ambiguity. In a similar vein, using simpler words may also provide greater clarity than a more obscure word choice.

Organized - Headings and sub-headings make it easier to navigate a document. It's also

helpful to have key aspects of a trust highlighted in some way. For example, naming a trust the ABC GST Exempt Trust provides useful information. Similarly, having a section labeled "Taxation" or "Grantor Trust Status" forces the attorney to consider the issue, and also makes it easy for future advisors to know the drafting attorney's intention with regard to a particular trust.







Categorizing Bad Drafting

- **Definitions**
- Ambiguity Drafting
- The "You Know What I Mean" Theory of Drafting
- Inconsistent Drafting
- Verbose
- **Bad Ideas that are Well Executed**





Improper Use of Definitions

The extensive use of defined terms can be a very elegant way to draft, but only if those terms are consistently used throughout your document.

It is also best practice to include definitions in a definition section whenever possible so someone reading the document can easily locate those terms.

Moreover, when a common term is used it's best not to have a novel or surprising definition tucked in the back of your document.



What do you think is the distribution standard?

"During my husband's life, my Trustees shall pay as much of the net income and principal of this trust, even to the extent of all or none, at any time and from time to time as my Trustee other than my husband shall determine in such Trustee's discretion to any one or more persons within a group consisting of my husband and my issue in any degree of consanguinity living from time to time."



Article Ten

In exercising his or her discretionary powers to pay or accumulate income and to pay principal of the trusts under this Will, my Trustee other than my husband (i) shall make such distributions only to the extent that such Trustee deems them necessary or advisable for the health, education, maintenance and support in reasonable comfort of the eligible recipient(s) thereof, or to enable any such person to maintain his or her accustomed standard of living, or for investment by such a person in any business enterprise...









Code references are fine... but READ the code

"The term "Independent Trustee" shall mean the Trustee who is not a beneficiary of any trust within the meaning of 26 U.S.C. Sec. 672(c)"





INFLATION ADJUSTMENTS

- •What is being adjusted?
- •When will the first adjustment be made? Starting when the trust is irrevocable? Starting one year after the death of someone?
- •How often will the adjustment be made?
- •How will inflation be measured?
- •Which CPI measure?
- •What if it is no longer being issued?
- Account for a delay in getting the CPI number





Sample Inflation Language

April 1st of each year, each descendant of mine shall receive a distribution of \$15,000 multiplied by the CPI Adjustment Factor. The CPI Adjustment Factor shall be a fraction, the numerator of which shall equal the Consumer Price Index, All Urban Consumers, U.S. City Average, All-Items Index (1982-84=100), published by the Bureau of Labor Statistics of the United States Department of Labor ("CPI-U"), or a comparable index if CPI-U is no longer published, for the December immediately preceding the date of the proposed distribution, and the denominator of which shall equal the corresponding CPI-U (or comparable index number) for May 2020.



Ambiguous Drafting



Ambiguity = Litigation

Perhaps the single biggest problem I see is ambiguity. When you are drafting a document it's easy to get caught in your own thinking and to believe what you have written could have only one reasonable meaning. Even if that is the case, I always fall back on what a wise colleague once told me. She said, "Reasonable people can disagree. Unreasonable people can disagree even more." Guess what kind of person a plaintiff's lawyer tends to be?





How a much do we set aside?

"If MARY SMITH is then living, the trustee shall distribute to the trustee shall distribute to the trustee herein named to be held as a separate trust, free of death taxes, a lump sum equal to the amount then necessary to provide annual payments to MARY SMITH as follows:

- 1. The Trustee shall pay to, or apply for the benefit of, MARY SMITH, the sum of Twenty-Four Thousand Dollars (\$24,000) per year, net of federal and state income taxes, during her lifetime, quarter annually or more frequently.
- 2. Following the death of MARY SMITH the trustee shall distribute the remaining balance of assets to the Children's Trust provided for in subparagraph_____. "





Don't Use Double Negatives

Compare:

"No Trustee who is not an 'Independent Trustee' shall...."

"Only an Independent Trustee shall..."

Compare:

"If my Trustee shall determine that it is no longer not in the Child's best interest for such payment to be made..."

"If my Trustee subsequently determines it is in the Child's best interest for such payment to be made..."



Can the Grantors name an individual Trustee?

Appointment of Successor Trustee. Upon the death, disability, removal or resignation of a Trustee, and if no Successor Trustee is designated in this Trust Agreement, the Grantors, or the surviving Grantor, shall have the right to appoint a Successor Trustee. The surviving Grantor may not appoint himself, herself or a subservient person as Successor Trustee of any credit shelter (exemption) Trust or QTIP Trust created under this Trust Agreement. If neither Grantor is able to appoint a Successor Trustee, then a majority of the adult income beneficiaries of the Trust may appoint a Successor Trustee. Such Successor Trustee must be a bank or Trust company having Trust powers.

Structure is Your Friend

Appointment of Successor Trustee.

- Upon the death, disability, removal or resignation of a Trustee, and if no Successor Trustee is designated in this Trust Agreement, the Grantors, or the surviving Grantor, shall have the right to appoint a Successor Trustee.
- The surviving Grantor may not appoint himself, herself or a subservient person as Successor Trustee of any credit shelter (exemption) Trust or QTIP Trust Created under this Trust Agreement.
- If neither Grantor is able to appoint a Successor Trustee, then a majority of the adult income beneficiaries of the Trust may appoint a Successor Trustee. Such Successor Trustee must be a bank or Trust company having Trust Powers.









How Many Trustee fees

Client had four children

- Each individual Trustee (other than the Grantor, the Grantor's spouse, or a descendant of the Grantor) who is not a professional shall be entitled to annual compensation in the amount of \$75,000 for services rendered as Trustee, and reimbursement for expenses incurred, and shall not be entitled to statutory or other scheduled or usual fiduciary fees.
- When Client died each child would have a GST exempt and a non-exempt trust.
- Is each trustee entitled to \$75,000 in fees or \$600,000?



The "You Know What I Mean" Theory of Drafting



A Crummy Crummey Power

Each beneficiary of this trust...may demand...a proportionate share of the entire amount of such contribution, but in no event shall the total of such sums so demanded and paid exceed Fourteen Thousand Dollars (\$14,000) per donor or such other lesser or greater amount as may be hereinafter set forth under the Internal Revenue Code and/or statutory and decisional law applicable thereto for each beneficiary named herein.



A Crummy Crummey Power

 Does the IRC say anything about rights to withdraw under this trust? Does a case?

Is zero the "lesser amount"?



The Laziest Crummey Power Ever?

Each beneficiary hereinabove designated as having a withdrawal power...shall be kept reasonably informed by the Trustee of contributions to the trust which create his or her right to exercise the specified withdrawal power. The Trustee shall, in any event, comply with whatever notice requirements are necessary in order to qualify contributions to the trust as gifts of a present interest for purposes of Section 2503(b) of the Code. Each such withdrawal right shall be exercisable only by a written instrument executed by the beneficiary having such right...followed by delivery to the Trustee within 30 days of any transfer.



Inconsistent Drafting



Is This a Mandatory Income Distribution?

"Trusts for Descendents...the Trustees may pay to the Beneficiary so much of the income therefrom and such sums out of the principal thereof (even to the extent of the whole thereof) as the Trustees, in their absolute discretion, shall determine, accumulating any balance of the income and adding it at least annually to principal.

When the Beneficiary attains age twenty-five and thereafter, the income of his or her trust shall be paid to the Beneficiary in convenient installments."



Is This a Mandatory Income Distribution?

• What does "convenient" mean?

• Compare to "...in convenient installments, but no less frequently than annually."

How about this one:

"My Co-Trustees shall pay to or apply to the use of my wife, DARLING WIFE, all of the income therefrom, annually or at more frequent intervals, and to accumulate and add to principal the balance, if any."



Mandatory Income...One More Time!

"The Trustee shall have the right to pay the net income from the trust to or apply to the use of the Beneficiary, or, if the Beneficiary shall be under the age of twentyone (21) to accumulate the net income from the trust (any accumulated net income shall be added to the principal of the trust fund)."



An Incentive Trust With Very Little Incentive

For any beneficiary that has not yet attained the age of thirty (30) years, my Trustee **shall** distribute an annual amount of income and principal equal to the amount that beneficiary **claimed as income** (taxable or nontaxable income) on that beneficiary's filed federal income tax return for the previous tax year



Can the "Not Child" of a Child Be a Grandchild?

- Adopted and after born persons Persons who are legally adopted while they
 are under 18 years of age (and not those persons adopted after attaining 18
 years of age) shall not be treated under this Agreement as though they were the
 naturally born children of their adopting parents.
- <u>Descendants</u> A person's descendants shall include all of his or her lineal descendants through all generations.
- My Grandchild is: PHIL, born Date 1, Elizabeth, born Date 2. All references to "my grandchildren" in this Agreement are to this grandchild as well as any children subsequently born to my children, or legally adopted by them.

Verbose Drafting: More is not Always Better



Formatting is Your Friend

The Grantor may remove any Trustee and appoint a Trustee or Trustees to succeed the removed Trustee. After the Grantor's death or incapacity, the Grantor's spouse, if the Grantor's spouse is the sole income beneficiary, otherwise a majority of the adult eligible income beneficiaries of any trust, with the concurrence of a majority of the adult presumptive remaindermen of such trust, may remove any Trustee of such trust and appoint a Trustee or Trustees to succeed the removed Trustee, provided the Grantor's spouse (if the Grantor's spouse is competent and is an eligible income beneficiary of such trust) consents to such action and at least one (1) adult income beneficiary and one (1) adult presumptive remainderman join in the exercise of such power.



Compare:

- 1. The Grantor may remove any Trustee of any trust created hereunder and appoint one or more successor Trustees.
- 2. After the Grantor's death or incapacity, if the Grantor's spouse is the sole income beneficiary of a trust the Grantor's spouse may remove any Trustee and appoint one or more successor Trustees of such trust.
- 3. After the Grantor's death or incapacity, if the Grantor's spouse is not the sole income beneficiary of a trust created hereunder a majority of the adult eligible income beneficiaries of such trust may remove any Trustee and appoint one or more successor Trustees of such trust, provided:
 - a. There is at least one adult presumptive remainderman of such trust and a majority of such remaindermen consent to such action; and
 - b. The Grantor's spouse consents to such action (if the Grantor's spouse is competent and is an eligible income beneficiary of such trust).



The One Sentence, 345 Word, Crummey Provision

With respect to each transfer of property to the trustee hereunder made (or deemed for purposes of the federal gift tax to have been made) by either or each of the donors during his or her lifetime, whether as the original of or as an addition to the trust property (but specifically excluding any and all property received by the trustee hereunder upon or by reason of the death of either of the donors), the trustee, in addition to, and not in lieu of, payments, transfers, distributions and/or applications of said principal made in accordance with and as authorized by other provisions of this Section 1, shall pay over to said GEORGE if he is living on the date said transfer is (or is deemed as aforesaid to be) made such (if any) sum or sums and/or other property from said principal as he shall, by instrument or instruments in writing delivered, or mailed by registered or certified mail, to the trustee hereunder at any time or from time to time within the period of thirty (30) days from and after the later to occur of (i) said date and (ii) the written notice to him with respect to said transfer hereinafter provided for, request the trustee so to pay over or transfer to him; PROVIDED, ALWAYS that the aggregate value of all sums and/or other property which said GEORGE shall, during any single calendar year, have the right to request the trustee to pay over or transfer to him pursuant to the provisions of this Subsection B shall in no event exceed the sum of twenty thousand (20,000) dollars and PROVIDED, FURTHER, that the trustee shall not pay over or transfer any sum and/or other property from said principal with respect to any transfer of property to the trustee hereunder if the donor or donors making such transfer shall, by instrument in writing received by the trustee prior to the date of such transfer, direct that said GEORGE shall have no right to request any such payment and/or transfer with respect to said transfer.



Organization Matters

- Page 1 approves income distributions, "the Trustee shall pay or apply so much or all of the net income to or for the use of the beneficiary, as the Trustee, in the sole and absolute discretion of the Trustee, shall determine, and the Trustee shall accumulate the balance, if any, of such net income not so paid or applied and add the same to principal..."
- Pages 1-12 cover (a) distribution on death of beneficiary, (b) trusts for descendants, (c) distribution of 20% of principal to beneficiary at 30, (d) rule against perpetuities, (e) crummey powers.



Page 12 of the Trust -

"Article Second (L) The Trustee is authorized and empowered to pay to or apply for the use or benefit of the Beneficiary of any trust under Article

First hereof such sum or sums, or such property from the principal of such trust and at such time or times as the Trustee, in the sole and absolute discretion of the Trustee, shall determine, for the Beneficiary's maintenance, education, comfort, best interest and welfare, or for such other purposes as the Trustee may deem appropriate..."



If You Write, "Notwithstanding" Consider a Redraft

If either HUSBAND or WIFE for any reason fails to qualify or ceases to act as Co-Trustee, the remaining Settlor will act as sole Trustee, but if HUSBAND is incompetent, TRUST COMPANY is appointed Co-Trustee with WIFE. If, for any reason, both HUSBAND and WIFE fail to qualify or cease to act as Trustees, then TRUST COMPANY is appointed as sole Trustee. Notwithstanding the above, on the death of the first spouse, TRUST COMPANY is appointed as the sole Trustee of the Marital Trust, Exemption Trust and Disclaimer Trust, if any, each as determined under Article III (Disposition to Surviving Spouse) of this Trust Agreement.



A Better Approach:

- 1. On the death of the first spouse, TRUST COMPANY is appointed as the sole Trustee of the Marital Trust, Exemption Trust and Disclaimer Trust, if any, each as determined under Article III (Disposition to Surviving Spouse) of this Trust Agreement.
- 2. If HUSBAND is incompetent, TRUST COMPANY is appointed CoTrustee with WIFE. If either spouse fails to qualify or ceases to act as Co-Trustee for any other reason, the remaining Settlor will act as sole Trustee.
- 3. If neither HUSBAND nor WIFE is serving as Trustee TRUST COMPANY shall serve as the sole Trustee.



Bad Ideas



The Hunger Games POA

Upon the death of the last to die of Settlor's children, the Trustees shall pay over ...to and among, ... such persons in such amounts and proportions ...as the last to die of Settlor's children, shall appoint by his/her Last Will and Testament, ... provided further, that the class of permissible donees of such power is limited to the Settlor's issue.





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